Effect of a Change in Medicare Eligibility on a Company's Retiree Health Liability for Two Hypothetical Workers

A discussion of how the change in Medicare eligibility might affect a company's retiree health liability for two hypothetical workers will illustrate how a few years of anticipated reduced costs for some retirees can significantly lower companies' liabilities. Consider the case of a 60-year-old worker who retires in 1991 and is expected to live to age 78. From assumptions about company health costs and medical inflation, we can project two benefit streams: one under the current system (stream A) and the other calculated as if the lowered Medicare eligibility had taken effect in 1991 (stream B). Each benefit stream represents the company's estimated annual retiree health costs for the worker.

Except for the 5 years from age 60-64, the benefit streams are identical; costs are 70 percent lower in stream B for these years. The present value of the benefit streams is obtained by discounting[6] the annual costs and summing the results. Stream B's present value ($21,129) is 36 percent lower than stream A's present value ($33,114) (see fig. 2).

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[6]Future costs are discounted (reduced in value) to reflect the time value of money. A $1,000 payment due in ten years, for example, has a present value of $508 if funds can be invested at 7 percent interest.